THE COMMONWEALTH OF MASSACHUSETTS
MASSACHUSETTS SENATE
SENATE COMMITTEE ON WAYS & MEANS
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Dear Colleagues:

We find ourselves this year in the midst of the worst national economic downturn since the Great Depression. Massachusetts has suffered a great deal already, with 92,000 jobs lost in the last six months and an unemployment rate of 7.8% in March. Revenue collections, highlighted by a drastic decline in capital gains, continue to deteriorate, threatening many of the programs and services provided in the commonwealth.

In January, the Administration, the House and the Senate agreed upon a tax revenue estimate of $19.53 billion for FY10. Since that time tax collections have continued to fall far short of necessary benchmarks. Given the deterioration of revenues in the current fiscal year, including a loss of $456 million in April collections (35% less than April of 2008), the Committee has concluded that the original FY10 consensus estimate is no longer realistic. The tax revenue estimate for these budget recommendations is $17.989 billion, $1.54 billion less than the original estimate.

Given these fiscal realities, the Senate Committee on Ways and Means recommends a fiscal year 2010 (FY10) operating budget of $26.720 billion. This represents a reduction in budgetary spending by $1.4 billion from the original fiscal year 2009 budget.

With a multi-billion dollar gap to fill, no area of state government is immune from significant reductions. The Committee focused on preserving the core functions of government, while mitigating damage to our safety net of services.

These recommendations utilize a modest portion of the Commonwealth's Stabilization Fund. The Fund, which ended fiscal year 2008 with a balance of $2.1 billion, has been tapped repeatedly in the current year to sustain government spending in the face of rapidly declining tax revenues. The Fund will most likely begin FY10 with a balance of under $1 billion. Recognizing the importance of maintaining a balance in this fund for future needs, this budget recommends a transfer of only $299 million. This small withdrawal balances short-term budgetary needs of the current fiscal crisis with the long-term goal of preserving a healthy reserve fund.

The Committee's recommendations fully utilize federal funds made available through the *American Recovery and Reinvestment Act* of 2009. These funds allow for continued support of important education and health care programs. The Committee's budget includes $1.109 billion in funds generated by an enhanced federal match on Medicaid spending. This funding allows the Commonwealth to continue open enrollment in our MassHealth and Commonwealth Care programs. Keeping these programs open is essential to the on-going success of our landmark health care reform effort.

The Committee also makes use of $366 million in federal stimulus funding to maintain support of K-12 education and higher education. Together with federal funding, this budget will fund chapter 70 at foundation level for all cities and town. Higher education spending will be maintained at fiscal year 2009 levels. While the committee supports eventually allowing for tuition retention for all institutions of higher education, the stimulus requirements prevented this change from occurring during FY10. We remain committed to this proposal and hope to implement it as soon as it is allowable.

Finally, we appropriate $11.9 million in Child Care and Development Block Grant stimulus funds for quality improvements and access to early education, and $5.6 million in Title IV E Foster Care and Adoption stimulus funds for the Department of Children and Families.

History of the Fiscal Crisis

While other states were starting to realize large recession-caused shortfalls, Massachusetts closed fiscal year 2008 $1 billion above initial revenue projections. Economists had indicated to us that unlike the recession of 2001-2003, when Massachusetts was hit quicker and harder than many other states, this present economic downturn was a consumer-based recession where our business diversity and strong business-to-business sector might continue to keep us from experiencing the full effect of this growing storm.

However, within this seemingly comforting news was one cautionary observation: if the recession prolongs, then the sheer weight of the consumer economy, which makes up close to 70% of our national economy, will end up pulling down even a more business centered economy like ours.

In fact, back in April of 2008, the news for Massachusetts was positive. The Massachusetts economy was far outpacing the national economy. GDP was growing at an annual rate of 3.2% compared to the national rate of 0.6%. While the national economy was losing 200,000 jobs at the start of the 2008 year, Massachusetts added 4,600 jobs.

In addition, Massachusetts was spared the worst of the housing collapse and mortgage industry meltdown because it did not experience the same level of speculative building as other parts of the country, such as California, Florida, and Nevada.

This outpacing was due in large part to our technology, science, higher education and healthcare sectors, as well as proportionally less speculative construction.

As the legislature put the finishing touches on fiscal year 2009's budget, we were mindful of that gathering storm. We proceeded with caution and prudence, relying on less than 2.5% revenue growth over our final tax collections from the year before. But even with this modest reliance on new revenue growth, we committed with the House and the Governor that if any significant decline in revenues were detected, then we would work together to act quickly. In fact, we instituted an important policy reform that mandated the Department of Revenue to start issuing mid-month revenue numbers as well as the usual monthly final.

As the first two months of fiscal year 2009 had come and gone (July and August), state revenues were actually $44 million over our benchmark projections. Then came September and the damaging winds of the global financial crisis came crashing down on top of the ongoing business recession, finally dragging Massachusetts into its depths. The mid-month report indicated a significant drop of $200-$250 million. We met with the House and the Administration to discuss plans for corrective action in anticipation of September's final numbers. September finally closed at $188 million below our estimates.

On Oct. 15, 2008, Secretary Kirwan decreased revenue projections by $1.1 billion and the Governor announced that the total gap was $1.4 billion due to outstanding deficiencies. To address this situation, the Governor proposed a $1.4 billion solution, most of which the legislature subsequently passed. This included: $665 million in budget cuts (including $84 million in earmarks); $52 million in voluntary cuts (from the Legislature, the Judiciary and the Constitutional Officers); $100 million in Pension Savings (by extending the schedule by two years to 2025); $155 million in additional revenue ($100 million in one-time tax settlements and $55 million from federal TANF revenue); $200 million from our Stabilization Fund; $30 million in transfer reductions ($10 million each from the e-Health Institute Fund, MA Alternative and Clean Energy Investment Trust, and the Massachusetts Life Sciences Investment Fund); and $52 million in a reduction of the pension transfer (due to revised need).

October's revenue came in $10 million above the revised benchmark. However, by November, the situation again started to erode. Tax collections ended up $41 million below benchmark. Tax collections for the month of December were favorable on the surface, $55 million above benchmark. However, this was due mostly to one-time large tax settlements of $170 million. Therefore, a true reflection of present economic activity was $115 million under benchmark.

On January 13th, 2009, Secretary Kirwan revised the consensus revenue downward by an additional $952 million to $19.45 billion. Combining that with other outstanding deficiencies, the total remaining FY09 gap was $1.1 billion. The Administration filed a plan to account for the remaining $1.1 billion gap, with $192.5 million from 9C reductions in line item spending, of which $128 million was a cut to local aid. The rest of the solution was as follows: Stabilization Transfer ($327 million); FY09 FMAP ($533 million); tax amnesty ($25 million); the removal of the sales tax exemption on alcohol, candy and soda in FY09 ($25 million, which was not enacted by the legislature).

Tax collections for January came in $25 million above the second revised downward benchmark. However, since January, tax collections have slumped even further. February's tax collections were $86 million below benchmark, and March was $53 million below benchmark. To account for this decline, Secretary Kirwan revised consensus revenue downward a third time by an additional $117 million to $19.33 billion and announced a package of $157 million in solves including $16 million in budgetary cuts and spending controls, $4.5 million in management furloughs within the Executive Branch and the elimination of 750 positions valued at $7.5 million. In addition to solutions within the state budget, the Governor also relied on Federal stimulus funds through the ARRA, specifically $38 million in Federal Recovery Grants and $90 million in State Fiscal Stabilization Funds.

The real punch came when tax collections for April were $456 million below benchmark due, in part, to a precipitous decline in capital gains. Secretary Kirwan had to, for the fourth time this year, reduce consensus revenue by $894 million to a new estimate of $18.436 billion. This represents a total decline of $ $2.966 billion from the original consensus revenue forecast in the FY09 budget. The solutions to this problem will be challenging, and will be announced by the Governor by May 19th.

This fall I attended a budget/management conference, and at one of the roundtables that I participated in, we were asked if good management decisions could be made during bad times. My answer was that sometimes in government, that's the only time they can be. Sometimes it takes hard times, or a crisis, to force a critical political mass to coalesce and embrace new ideas and difficult decisions. If "necessity is the mother of invention" then crisis can be the "father of change". Not change for the sake of change, but good, solid reform that will get us through the difficult times, but not be scrapped when the emergency is resolved or dissipates. We should take advantage of the situation and place ourselves in a position to be ready for future economic downturns and uncertainties.

The last recession was termed by some "the perfect storm," but it was still within the norms of past economic cycles and models. I believe that our current economic crisis is not within these norms. It is, in many ways, "the imperfect storm."

Just like Odysseus, whose ancient voyage in unchartered waters, had to confront simultaneously, the twin evils of Scylla and Charybdis, our ship of state has had to navigate the duel dangers of a recession and a financial crisis, which are proving to be even more problematic than originally contemplated. Rest assured, we will get through, but it will take the shared sacrifice of all of us.

The budget process is always a challenging task, but this year proved to be especially complex and trying. These recommendations are the result of exceptional work by both the membership and staff. I would like to extend my gratitude to my colleagues, in particular the members of the Senate Committee on Ways and Means for their dedication and commitment to this process and to the people of the commonwealth.

For the Committee,

Steven C. Panagiotakos
Chairman
Senate Committee on Ways and Means